# WesternStar Exploration Ltd.

1996

ANNUAL REPORT

## Corporate Profile

Western Star Exploration Ltd. is a Calgary based oil and natural gas exploration, development and production company operating in the Western Canadian sedimentary basin.

Western Star was incorporated in 1988 under the name Western Star Energy Corporation and reorganized as a public company on The Alberta Stock Exchange in 1992 after a reverse take-over of Swiss Canadian Resources Inc. The Company changed its name to Western Star Exploration Ltd. at the time of a stock consolidation in September, 1994. The Company's present trading symbol on The Alberta Stock Exchange is "WSX".

The Company believes that its competitive advantage lies in its geological expertise. Western Star's strategy is to grow primarily through exploration, with the goal of creating significant long-term value for its shareholders.

## Annual General Meeting

The Annual General Meeting of Shareholders will be held at 10:00 a.m. on Thursday, December 19, 1996 in the offices of the Corporation, Suite 402, 1000 - 8th Avenue S.W., Calgary, Alberta.

## Abbreviations

| | |
|---|---|
| Bbl | barrel |
| Bbls/d | barrels per day |
| Bcf | billion cubic feet |
| Boe | barrel of oil equivalent (10 Mcf = 1 Boe) |
| Mboe | thousand barrels of oil equivalent |
| Mbbls | thousand barrels |
| Mcf | thousand cubic feet |
| Mcf/d | thousand cubic feet per day |
| Mmcf | million cubic feet |
| Mmcf/d | million cubic feet per day |
| NGLs | natural gas liquids |

## Contents

# Highlights

| | **12 months ended June 30, 1996** | 12 months ended June 30, 1995 | Change |
|---|---|---|---|
| **Financial** (thousands of dollars, except as noted) | | | |
| Revenue, Net of Royalties | **1,413** | 1,416 | 0% |
| Cash Flow | **731** | 752 | -3% |
| Per Share ($) | **0.18** | 0.18 | 0% |
| Net Earnings | **68** | 135 | -50% |
| Per Share ($) | **0.02** | 0.03 | -49% |
| Capital Expenditures | **2,489** | 1,311 | +90% |
| Long-Term Debt | **0** | 11 | -100% |
| Shareholders' Equity | **5,061** | 5,038 | 0% |
| Common Shares Outstanding at Year End | **4,153,192** | 4,208,642 | -1% |
| **Operating** | | | |
| Average Production | | | |
| Gas (Mcf/d) | **1,353** | 1,481 | -9% |
| Oil & NGLs (Bbls/d) | **77** | 65 | +18% |
| Average Sales Price | | | |
| Gas ($/Mcf) | **1.48** | 1.49 | -1% |
| Oil & NGLs ($/Bbl) | **23.96** | 22.47 | +7% |
| Operating Costs | | | |
| Gas ($/Mcf) | **0.43** | 0.37 | +15% |
| Oil and NGLs ($/Bbl) | **6.18** | 5.82 | +6% |
| Reserves at Year End | | | |
| Gas (Bcf) | **3.6** | 2.8 | +26% |
| Oil and NGLs (Mbbls) | **136** | 174 | -22% |
| Oil Equivalents (Mboe) | **493** | 456 | +8% |

# *Message To Our Shareholders*

## ACCELERATING OUR GROWTH IN 1997

A year ago we outlined in our Annual Report how a restructured Western Star was committed to build the momentum of growth. Today the company is moving forward and this year's goal is to accelerate our growth.

### FOCUSING OUR EXPLORATION EFFORTS

During fiscal 1996, Western Star developed ten exploration prospects. Five of them reached the drilling stage; the others are yet to be drilled. Not all were successful, but one project, in the Worsley area of Northwest Alberta, emerged as very promising, with two successful wells out of two attempts and more untapped potential identified.

During fiscal 1997, we are planning to focus our exploration efforts; to pursue fewer projects, more extensively, with higher working interests; in other words, to develop core exploration areas. Today we see two such core areas. One will be the Worsley area. Another one will be an area over which Western Star has conducted an in-depth regional geological study for the past nine months. We expect that this study will result in several new prospects that could have significant reserve potential.

### LEAPING FORWARD WITH A CORPORATE ACQUISITION

Subsequent to year-end, effective July 1, 1996, Western Star entered into a share exchange agreement with 388623 Alberta Ltd. ("388623"), a wholly owned subsidiary of The Standard Life Assurance Company ("Standard"). This transaction closed on October 31, 1996, and can be summarized as follows:

- Western Star acquired all of the shares of 388623 by issuing to Standard 4,100,000 shares and 1,000,000 warrants (each to purchase one share for $1.25 on or before October 31, 1999). Standard became Western Star's largest shareholder with 49.7% of the issued and outstanding shares.

- 388623's assets are composed of P&NG properties, undeveloped land and $1,238,000 in working capital at July 1, 1996.

- The largest P&NG asset is an 18.75% working interest in a shallow gas property in Hanna, Southeast Alberta, where 57 wells were put on stream in March, 1996 at a gross rate of approximately 5 Mmcf per day. This long life property also includes an interest in the plant and gathering system and adjacent lands with development potential. The gas will be sold to a premium priced export market as of November 1, 1996.

- 388623 has $18 million in tax pools, including a $5 million loss carry forward that Western Star will be able to use to shelter income from its existing or future properties.

We are very excited with this acquisition and believe it is an important steppingstone for our company.

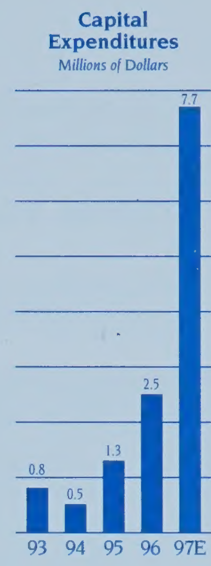
- Western Star becomes a stronger, more competitive company, with greater "staying power" in the exploration race (cash-flow will increase to $1.4 million and production to 500 Boe/d for fiscal 1997);

- Western Star receives a cash influx of $1.3 million at a time when more capital is needed to develop the existing projects (we expect the fiscal 1997 budget to exceed $4 million, in addition to this acquisition);

- The existing management team is strengthened with the appointment of Mr. Curtis B. Walsh as Vice-President, Finance. We will be adding a senior geologist to our staff on a full time basis. The Board of directors is strengthened with the appointment of Mr. Norman Raschkowan, Vice-President, Equities of Standard;

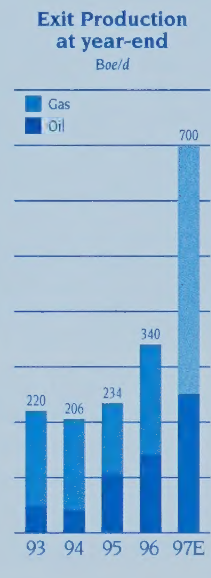
- The addition of a long-life gas property to Western Star's asset portfolio increases the average reserve life and provides good leverage to rising gas prices;

- Finally, the tax pools will give Western Star a competitive advantage for further strategic acquisitions, with the goal of reaching "critical mass" and being more effective in cash-flow reinvestment.



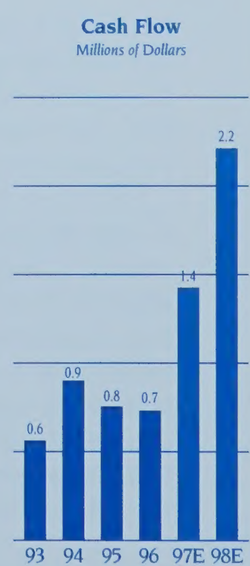

## TARGETING OUR GROWTH

| Our immediate targets: | | Increase over 1996 |
|---|---|---|
| • exit production June 30, 1997: | 700 Boe/d | + 100% |
| • cash flow fiscal 1997: | $1.4 million | + 94% |
| • cash flow fiscal 1998: | $2.2 million | + 200% |




Western Star's strengthened balance sheet and inventory of projects create a very positive outlook for 1997. In addition to our exploration projects, we have substantial development plans for our two main producing properties at Thornbury and Hanna. Western Star expects to participate in 40 to 50 wells in the next twelve months. Total capital investment, including the acquisition from Standard, will exceed $7 million during fiscal 1997. The next stage of growth will be for Western Star to take larger working interests in its prospects and eventually become an operator. We expect this to happen before the end of 1997.

We welcome The Standard Life Assurance Company as a major new shareholder. We thank our existing shareholders for their continued support. To all we reaffirm our commitment to increasing the value of their investment.




For and on behalf of the Board,

Kevin J. Gibson
President

# *Review of Activity*

This section of the report details Western Star's capital expenditures program and operations. Financial results are discussed in the "Management's Discussion and Analysis" section.

## Capital Expenditures

Western Star invested $2,480,000 in the exploration, development and production of petroleum and natural gas during the fiscal year ended June 30, 1996.

These capital expenditures can be broken down into two categories:

- **Consolidation of existing production** **25%**
- **Development of new exploration projects** **75%**

Overall, Western Star drilled eleven wells (2.1 net) wells, resulting in five (0.7 net) gas wells, one (0.6 net) oil well and five (0.8 net) dry holes.

## Consolidation of Existing Production

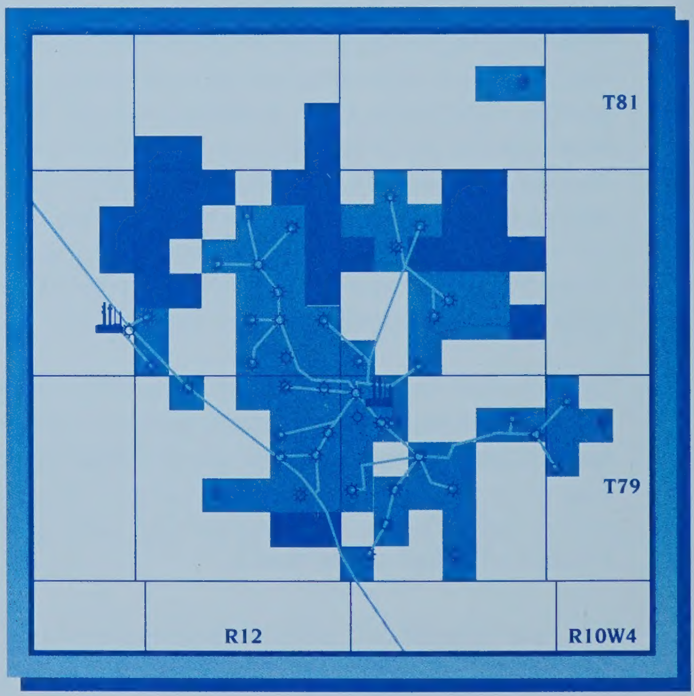
Western Star invested $630,000, or 25% of its capital expenditures, in the maintenance and upgrading of its existing production properties.

### Thornbury

Most of this investment ($400,000) was made in Western Star's main producing property in the Thornbury area of Northeast Alberta, where the company holds an average 10% working interest in thirty gas wells producing an aggregate of 11 Mmcf/d into two compression facilities. The producing formations are the McMurray and the Colony sandstones.

During this past winter, Western Star drilled one (0.1 net) new gas well and earned an interest in three other wells by tying them in. A total of seven wells were tied-in in February to keep the main compressor station operating at full capacity.

In June, Western Star acquired a 10% working interest in thirty-one sections of undeveloped land adjacent to its existing holdings, as shown on this map. Significant development is envisioned on these lands for the coming winter. In our 1997 budget, we have allocated $600,000 to Thornbury and we aim at increasing our net production from this property by 50%, with the drilling and tie-in of 11 wells and a plant expansion.




Lands acquired in June 1996

### Other Properties:

Another $230,000 was spent in various operations on existing properties, as outlined below.

- **Rainbow Airport**

A year ago Western Star drilled an exploratory oil well into a Keg River reef in Township 109 Range 6 W6M. Artificial lift equipment and a flow line were installed during this winter, ensuring year-round production. Western Star holds a 20% working interest in the well, reverting to a 12% working interest after payout. Gross oil production at June 30, 1996, was 80 Bbls/d (16 Bbls/d net to Western Star).


- **Brooks, Charlotte Lake, Driftwood**

In these minor properties, Western Star participated in three (0.4 net) development wells that resulted in dry holes.

## Production And Reserves

The following table summarizes Western Star's main properties by both 1996 production and June 30, 1996 reserve volumes, as evaluated by NRG Engineering Ltd.

### Oil and NGLs Properties

| | 1996 Production | | Reserve Volumes (Mbbls) | |
|---|---|---|---|---|
| | Bbls/d | % of Total | Proven + 50% Probable | % of Total |
| Rainbow | 36 | 47 | 71 | 52 |
| Worsley | 20 | 26 | 54 | 40 |
| Zama | 19 | 25 | 10 | 7 |
| Other properties | 2 | 2 | 1 | 1 |
| Total | 77 | 100 | 136 | 100 |

### Natural Gas Properties

| | 1996 Production | | Reserve Volumes (Mmcf) | |
|---|---|---|---|---|
| | Mcf/d | % of Total | Proven + 50% Probable | % of Total |
| Thornbury | 958 | 71 | 2,241 | 63 |
| Hatton, Saskatchewan | 148 | 11 | 386 | 11 |
| Wolf Lake | 120 | 9 | 116 | 3 |
| Other properties | 127 | 9 | 820 | 23 |
| Total | 1,353 | 100 | 3,563 | 100 |

## Development of New Exploration Projects

Western Star developed ten exploration projects during this past year, investing:

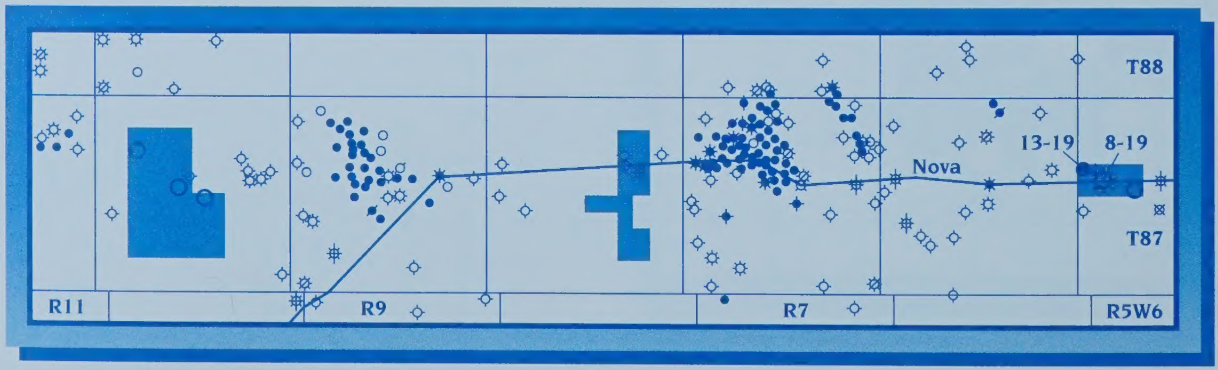
- $550,000 in geological research and seismic data acquisition, which included three proprietary 3-D seismic surveys;
- $640,000 in the acquisition of 13,000 net acres of undeveloped land;
- $480,000 in the drilling of six exploratory wells and a re-entry, resulting in four gas wells, one oil well and two dry holes;
- $180,000 in tie-in and facilities costs for two gas wells that were placed on production before year-end.

Six exploratory wells were drilled on five different projects. The following discussion details the results of this drilling program. The five remaining exploration projects will be evaluated during fiscal 1997 and are not discussed further in this report.

### Worsley - A new core area

Of the five projects evaluated through drilling this year the Worsley project emerged as offering the best risk/reward ratio and will be the main focus of Western Star's exploration activity for fiscal 1997. This area presents significant reserve potential within a short distance of an existing pipeline system. It also offers good land availability, although the competition is increasing in the area, preventing a more specific disclosure of this geological play.

In June 1995, Western Star drilled an exploratory oil well in section 19 Township 87 Range 5 W6M. Western Star increased its working interest in the well this year to 20%. Production from the well was restricted most of the year to the allowable rate of 64 Bbls/d. Good Production Practice status was granted in May 1996 and gross production at year-end was 200 Bbls/d (40 Bbls/d net to Western Star).




O Drilling locations on Western Star's lands

In March 1996, Western Star drilled a second well in the same section, with a 22.25% working interest. This 8-19 well encountered a gas bearing reservoir. Western Star and its partners set up a processing facility and tied the well into the nearby Nova pipeline after spring break-up. Production began in June 1996. Current gross rate is approximately 1 Mmcf/d of natural gas and 15 Bbls/d of condensate.

Building upon the knowledge acquired with these two wells, Western Star and its partners have been acquiring undeveloped land in this area. At year-end, Western Star held an average 18% working interest in 15 sections. Several drilling locations have been identified. Western Star has budgeted approximately $1 million for this area for 1997, with four to eight wells to be drilled.

### Mikwan

Another project resulted in the discovery of a Glauconite gas pool at Mikwan, Central Alberta. The well was on stream at year-end at a gross rate of 500 Mcf/d (70 Mcf/d net to Western Star's 14% working interest). The current land situation precludes any further development at this time.

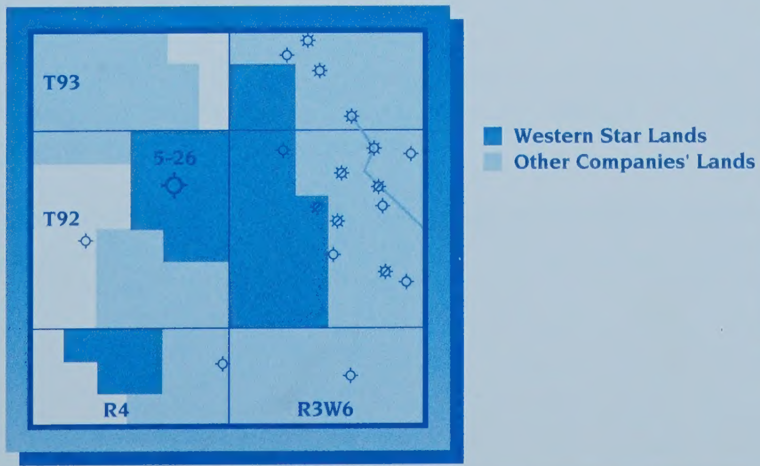
### Pyramid

Western Star drilled two gas wells with a 10% working interest in the Pyramid area of Northwest Alberta. This area, although currently remote from pipeline access, is being actively developed by several large exploration and production companies. Western Star and its partners received offers from these companies for the purchase of these two wells and surrounding lands. Given the nature of the competition and the fact that these wells would not be placed on production for at least two years, Western Star and its partners agreed to sell out of the area.

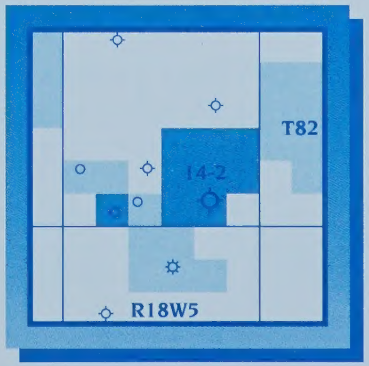
### Sutton, Harmon

The dry holes drilled in the Sutton and Harmon areas of Northwest Alberta hampered the attractiveness of these two projects with regard to the geological formation that was the primary target of the drilling. Both of these prospects, though, present multi-zone potential, and some exploration successes have been recorded on lands surrounding the significant land positions held by Western Star and its partners, as seen on these maps. Over the coming year, the company plans to further evaluate these prospects while closely monitoring operations on offsetting lands.

Sutton




Harmon



### Rainbow

In June 1996, Western Star successfully re-entered a suspended Keg River reef well in the Rainbow area with a 60% working interest, resulting in net production of 40 Bbls/d of light oil. The well has potential for increased production through a horizontal re-entry in the future. Western Star has also identified a drilling location on a land parcel that it acquired after year-end. The Company intends to drill a Keg River test on this land before the end of calendar year 1996.

## Reserves Reconciliation

The drilling operations described above resulted in an aggregate reserve addition, net to Western Star, of 45 Mbbls of light crude oil and 0.9 Bcf of natural gas, or the equivalent of approximately two years of production. The Company, however, incurred revisions of previously booked reserves which partially offset the net reserve additions.

### Oil and NGLs (Mbbls)

| | Proved | Probable | Proved +50% Probable |
|---|---|---|---|
| June 30, 1995 | 157 | 33 | 174 |
| Extensions and discoveries | 40 | 10 | 45 |
| Revisions | (47) | (15) | (55) |
| Production | (28) | - | (28) |
| June 30, 1996 | 122 | 28 | 136 |

### Natural Gas (Bcf)

| | Proved | Probable | Proved +50% Probable |
|---|---|---|---|
| June 30, 1995 | 2.8 | 0 | 2.8 |
| Extensions and discoveries | 0.8 | 0.2 | 0.9 |
| Revisions | 0.4 | 0 | 0.4 |
| Production | (0.5) | - | (0.5) |
| June 30, 1996 | 3.5 | 0.2 | 3.6 |

# Management's Discussion and Analysis

The following discussion and analysis compares the financial and operating results for the fiscal year ended June 30, 1996 with the fiscal year ended June 30, 1995.

## Revenue

Revenue from oil and natural gas sales rose by 3% to $1,438,000 from $1,390,000 in 1995. This increase was due to an increase in oil sales, as shown by the following table:

### Revenue Analysis

| (thousands of dollars) | **1996** | 1995 |
|---|---|---|
| Natural gas sales | **733** | 807 |
| NGLs sales | **9** | 2 |
| Oil sales | **665** | 535 |
| Processing revenue and other sales | **31** | 46 |
| Total sales | **1,438** | 1,390 |

During fiscal 1996, oil sales accounted for 46% of the Company's gross sales, compared to 38% for fiscal 1995 and 22% for 1994.

The 24% increase in oil sales was due to an 18% rise in oil production combined with a 7% increase in price ($23.96 per Bbl compared to $22.47 a year ago). Oil production rose as a result of a new oil well drilled and put on production in the Worsley area. Essentially all of the oil produced by Western Star is a light-gravity crude that receives a premium price.

The 9% decline in natural gas sales resulted from a 9% production decline and a 1% decrease in the average gas price received ($1.48 per Mcf compared to $1.49 a year ago).

Western Star sells most of its gas through long-term contracts to a variety of markets and expects to maintain a premium over Alberta spot gas prices in the current fiscal year.

## Royalties

Royalties paid to the Crown, freehold owners and third parties, net of Alberta Royalty Tax Credit ("ARTC") increased by 4% to $119,000 from $115,000 in 1995. Royalties as a percentage of gross revenue remained unchanged at 8%.

Western Star's benefit from the ARTC program during fiscal 1996 was $82,000.

## Production Expenses

Production expenses for fiscal 1996 were $386,000 compared to $341,000 in 1995.

Expenses associated with oil production increased by $35,000 from $139,000 in 1995 to $174,000 mainly as a result of the operation of one additional well.

Expenses associated with natural gas production increased marginally by $10,000 to $212,000. Western Star usually owns an interest in the natural gas plants handling its gas production and therefore incurs mostly fixed expenses, which do not decline with a lower production throughput.

## Product Netbacks

Netbacks represent the amount that the Company nets, on a per unit basis, from the sale of its petroleum and natural gas after all direct costs, such as royalties and production costs, are deducted. Western Star's netbacks are summarized below:

### Netbacks Per Unit

| **Natural Gas** ($ per Mcf) | **1996** | 1995 |
|---|---|---|
| Price | **$ 1.48** | $1.49 |
| Royalties, net of ARTC | **0.10** | 0.14 |
| Operating costs | **0.43** | 0.37 |
| Netback | **$ 0.95** | 0.98 |

| **Oil and NGLs** ($ per Bbl) | **1996** | 1995 |
|---|---|---|
| Price | **$ 23.96** | $22.47 |
| Royalties, net of ARTC | **2.42** | 1.69 |
| Operating costs | **6.18** | 5.82 |
| Netback | **$ 15.36** | 14.96 |

## General And Administrative Expenses

General and administrative expenses were reduced by 9% to $292,000 in1996 from $319,000 in 1995, mainly the result of non-recurring charges incurred in fiscal 1995.

During fiscal 1996, Western Star capitalized $99,000 of overhead costs related to exploration and development compared to $105,000 in 1995.

## Interest And Other Income

Western Star has no bank debt and interest expense was limited to interest paid on the capital lease of a compressor in the Thornbury property, for an amount of $3,000, compared to $4,000 in 1995.

The Company reported $64,000 of interest income for 1996 compared to $141,000 for 1995; this income was earned on short-term investment of its cash balance.

Reported as other income is a $31,000 settlement payment that Western Star received for the termination of a gas marketing contract for its Hatton property.

## Depletion, Depreciation And Site Restoration

Depletion, depreciation and site restoration expenses combined were $674,000 or $8.70 per Boe produced of which $0.17 per Boe related to site restoration charges. In 1995, the corresponding costs were $566,000 or $7.27 per Boe.

## Income Taxes

Western Star did not pay current income taxes for fiscal 1996, and will not be taxable in 1997.

## Cash Flow

Cash flow from operations was $731,000 or $0.18 per share, compared to $752,000 or $0.18 per share in 1995.

The following table provides an analysis of the various components of cash flow from operations, on a per unit of production basis (gas converted to oil equivalent on the basis of 10 Mcf = 1 Boe).

### Cash-Flow Netback Analysis

| ($ per Boe) | **1996** | 1995 |
|---|---|---|
| Oil and gas sales revenue | **$ 18.55** | $ 17.83 |
| Royalties, net of ARTC | **(1.54)** | (1.47) |
| Interest and other income | **1.22** | 1.81 |
| Net revenue | **$ 18.23** | $ 18.17 |
| Operating expenses | **(4.98)** | (4.38) |
| General and administrative expenses | **(3.77)** | (4.10) |
| Interest expenses | **(0.04)** | (0.05) |
| Cash-flow from operations | **$ 9.44** | $ 9.64 |

## Net Earnings

Net earnings were $68,000, or $0.02 per share, compared to $135,000, or $0.03 per share in 1995.

## Capital Expenditures

Western Star's oil and gas expenditures increased in fiscal 1996 to $2,477,000 from $1,295,000 in 1995.

The following table summarizes the Company's capital expenditures on a comparative basis:

**Capital Expenditures**

| (thousands of dollars) | **1996** | 1995 |
|---|---|---|
| Undeveloped land | **842** | 140 |
| Seismic surveys and geology | **455** | 345 |
| Drilling and completion of wells | **615** | 533 |
| Well equipment and facilities | **466** | 172 |
| Capitalized overhead | **99** | 105 |
| Total oil and gas expenditures | **2,477** | 1,295 |
| Administrative expenditures | **12** | 16 |
| Total capital expenditures | **2,489** | 1,311 |

Cash-flow from operations funded approximately 30% of the capital expenditures, the balance being provided by Western Star's working capital.

## Liquidity And Capital Resources

Working capital at year end was $113,000, compared to $1,927,000 at June 30, 1995.

As at June 30, 1996, Western Star had 4,153,192 shares issued and outstanding, compared to 4,208,642 at June 30, 1995. This total reflects the repurchase of 57,950 shares under a normal course issuer bid for a consideration of $44,940 and the issue of 2,500 shares as a result of the exercise of options. The Company renewed its issuer bid on May 10, 1996 for a further year as it believes its shares have been trading lately at a discount to net asset value.

As at June 30, 1996, Western Star had reserved 405,000 shares for employees and directors stock options.

## Corporate Outlook

Significant growth is expected during fiscal year 1997. Beyond the acquisition of the petroleum and natural gas properties of 388623 Alberta Ltd. for a consideration valued at $3.2 million, Western Star has budgeted an additional $4.5 million in capital expenditures for the fiscal year. This compares to a total of $2.5 million invested in 1996. Of the $4.5 million, we estimate that 35% will be spent on the consolidation of existing production, with 65% to be spent on the development of new projects.

The funding of this capital budget will be provided partially through the reinvestment of cash flow from operations, supplemented by the use of Western Star's working capital and debt and equity financing.

### Cash-Flow Projections

Expected cash-flow from operations depends upon a number of factors that are often very volatile.

One main uncertainty is the degree of success and the timing of the development of new projects. In order to present a conservative outlook, we established a cash-flow forecast based only on the existing properties of Western Star and 388623 Alberta Ltd. as at July 1, 1996. Any new property that would come on stream during the year will directly add incremental cash-flow to this forecast.

On that basis, we project Western Star's cash flow for fiscal 1997 as follows:

| | |
|---|---|
| Pricing assumptions: | |
| Crude Oil: | U.S. $20.50 per Bbl WTI |
| Natural Gas: | Aeco Spot $1.25 Cdn. per GJ |
| | NYMEX Henry Hub U.S. $2.20 per Mmbtu |
| Exchange Rate: | $0.74 Cdn./U.S. Dollar |
| Average field prices received by Western Star: | |
| Crude Oil: | $24.10 per Bbl |
| Natural Gas: | $1.36 per Mcf |
| Average Daily Production: | |
| Crude Oil and NGLs: | 119 Bbls/d |
| Natural Gas: | 3.833 Mmcf/d |
| Total: | 504 Boe/d |
| Revenue, Net of Royalties: | $2,740,000 |
| Cash-Flow from Operations: | $1,420,000 |
| Cash-Flow per Share: | $0.17 |
| Net Earnings per Share: | $0.03 |

The following table shows the estimated effect of changes in commodity prices, the exchange rate and production levels on Western Star's projected cash-flow for fiscal 1997.

**Sensitivity Analysis / Effect on 1997 Projected Cash Flow**

| | $M | $ per share |
|---|---|---|
| $1.00 U.S. per Bbl change in WTI Oil Price | 53 | 0.006 |
| $0.10 per Mcf change in Gas Price | 126 | 0.015 |
| $0.01 U.S. change in the value of the Cdn. dollar | 24 | 0.003 |
| 10 Bbls/d in Oil Production | 60 | 0.007 |
| 100 Mcf/d in Gas Production | 30 | 0.004 |

# *Auditors' Report*

To the Shareholders of **Western Star Exploration Ltd.**

We have audited the balance sheets of **Western Star Exploration Ltd.** as at June 30, 1996 and 1995 and the statements of earnings and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Deloitte & Touche

Chartered Accountants

Calgary, Alberta
September 12, 1996

# *Statements of Earnings and Retained Earnings*

For The Years Ended June 30

| | 1996<br>$ | 1995<br>$ |
|---|---|---|
| **REVENUE** | | |
| Production revenue | **1,437,515** | 1,390,387 |
| Royalty expense | **(201,313)** | (231,544) |
| Alberta Royalty Tax Credit | **81,818** | 116,446 |
| | **1,318,020** | 1,275,289 |
| Interest and other | **95,044** | 141,155 |
| | **1,413,064** | 1,416,444 |
| **COSTS AND EXPENSES** | | |
| Operating | **386,175** | 341,471 |
| Depletion and depreciation | **661,055** | 550,992 |
| Future site restoration and abandonment costs | **13,303** | 15,451 |
| General and administrative | **292,316** | 319,310 |
| Interest (Note 5) | **3,298** | 4,030 |
| Loss on disposal of capital assets | **521** | 5,934 |
| | **1,356,668** | 1,237,188 |
| **Earnings before income taxes** | **56,396** | 179,256 |
| **Recovery of (provision for) income taxes** | | |
| Deferred (Note 7) | **11,290** | (44,645) |
| **NET EARNINGS** | **67,686** | 134,611 |
| **Retained earnings, beginning of year** | **719,495** | 584,884 |
| **Retained earnings, end of year** | **787,181** | 719,495 |
| **Earnings per share, basic (Note 8)** | **.02** | .03 |

# *Balance Sheets*

As At June 30

| | 1996 $ | 1995 $ |
|---|---|---|
| **ASSETS** | | |
| **Current** | | |
| Cash and short term investments | **85,345** | 1,729,870 |
| Accounts receivable | **511,800** | 467,154 |
| Prepaid expenses | **4,733** | 5,795 |
| | **601,878** | 2,202,819 |
| Petroleum and natural gas properties and equipment (Note 3) | **5,082,778** | 3,260,522 |
| Capital assets (Note 4) | **32,405** | 26,877 |
| | **5,717,061** | 5,490,218 |
| **LIABILITIES** | | |
| **Current** | | |
| Accounts payable and accrued liabilities | **477,826** | 257,376 |
| Current portion of capital lease obligation (Note 5) | **11,405** | 18,366 |
| | **489,231** | 275,742 |
| Capital lease obligation (Note 5) | **-** | 11,405 |
| Future site restoration and abandonment costs | **65,415** | 52,112 |
| Deferred income taxes | **101,655** | 112,945 |
| | **656,301** | 452,204 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (Note 6) | **4,249,279** | 4,308,605 |
| Contributed surplus (Note 6(b)) | **24,300** | 9,914 |
| Retained earnings | **787,181** | 719,495 |
| | **5,060,760** | 5,038,014 |
| | **5,717,061** | 5,490,218 |

**APPROVED BY THE BOARD**

Director
Lyle P. Edwards

Director
Kevin J. Gibson

# Statements of Changes in Financial Position

For The Years Ended June 30

| | 1996<br>$ | 1995<br>$ |
|---|---|---|
| **Net inflow (outflow) of cash related to the following activities:** | | |
| **Operating** | | |
| Net earnings | **67,686** | 134,611 |
| Items not affecting cash | | |
| Depletion and depreciation | **661,055** | 550,992 |
| Future site restoration and abandonment costs | **13,303** | 15,451 |
| Deferred income taxes | **(11,290)** | 44,645 |
| Loss on disposal of capital assets | **521** | 5,934 |
| | **731,275** | 751,633 |
| Changes in non-cash operating working capital items | | |
| Accounts receivable | **(44,646)** | (141,194) |
| Prepaid expenses | **1,062** | (1,057) |
| Accounts payable and accrued liabilities | **220,450** | 44,752 |
| | **908,141** | 654,134 |
| **Financing** | | |
| Repayment of capital lease obligation | **(18,366)** | (16,584) |
| Repurchase of shares | **(44,940)** | (31,650) |
| | **(63,306)** | (48,234) |
| **Investing** | | |
| Additions to petroleum and natural gas properties and equipment | **(2,476,661)** | (1,295,271) |
| Additions to capital assets | **(12,745)** | (16,040) |
| Proceeds on disposal of capital assets | **46** | - |
| | **(2,489,360)** | (1,311,311) |
| **NET CASH OUTFLOW** | **(1,644,525)** | (705,411) |
| **Cash and short-term investments position, beginning of year** | **1,729,870** | 2,435,281 |
| **Cash and short-term investments position, end of year** | **85,345** | 1,729,870 |

# Notes to the Financial Statements

For The Years Ended June 30, 1996 and 1995

## 1. Description of Business

Western Star Exploration Ltd. is a public company incorporated under the Alberta Business Corporations Act. The Company is in the business of exploration for and development and production of oil and gas properties, primarily in western Canada.

## 2. Accounting Policies

### Petroleum and Natural Gas Properties and Equipment

The Company follows the full-cost method of accounting for petroleum and natural gas properties whereby all costs relating to the exploration for and development of petroleum and natural gas reserves, whether producing or non-producing, are capitalized. Such costs include land acquisition costs, geological and geophysical costs, cost of drilling producing and non-producing wells, and overhead related to exploration activities. Proceeds from disposal of properties are normally deducted from costs without recognition of gain or loss. In the case of major property disposals, the net cost of the properties is deducted from the proceeds, and the resulting gain or loss, net of applicable income taxes, is included as part of income for the year.

Depletion of petroleum and natural gas properties and equipment is provided on a unit-of-production method based on estimated proved reserves of oil and gas as determined by independent petroleum engineers, after royalties and estimated salvage values, converted to a common unit of measurement based on a ratio of 6 mcf of gas to one barrel of oil.

The Company compares the net book value of its petroleum and natural gas properties and equipment to the estimated future net revenues, using actual prices being received by the Company at June 30 plus the lower of cost and estimated fair value of undeveloped lands, and after deducting estimated future general and administrative expenses, site restoration and abandonment costs, financing costs and income taxes. Any indicated deficiency as a result of this comparison is charged to current operations as part of depletion and depreciation expense.

### Future Site Restoration and Abandonment Costs

Estimated future site restoration and abandonment costs are charged to operations on a unit of production basis.

### Capital assets

Capital assets are recorded at cost and are depreciated using the declining-balance method at the rate of 20%.

### Joint Ventures

Substantially all of the Company's operations are conducted through joint operations and, accordingly, the accounts include only the Company's proportionate interest in such activities.

## 3. Petroleum And Natural Gas Properties And Equipment

| | 1996 $ | 1995 $ |
|---|---|---|
| Petroleum and natural gas properties and equipment | **10,385,749** | 7,909,088 |
| Petroleum and natural gas equipment under capital lease | **81,071** | 81,071 |
| | **10,466,820** | 7,990,159 |
| Accumulated depletion and depreciation | **5,366,204** | 4,716,268 |
| Accumulated amortization of petroleum and natural gas equipment under capital lease | **17,838** | 13,369 |
| | **5,384,042** | 4,729,637 |
| | **5,082,778** | 3,260,522 |

Included in petroleum and natural gas properties and equipment at June 30, 1996 are expenditures of $1,182,230 (1995 - $343,221) related to unproved properties. These costs have been excluded from the depletion calculation until such time as proved reserves are attributed to the property or impairment in carrying values occurs.

For the year ended June 30, 1996, the Company capitalized $99,000 (1995 - $104,500) of overhead costs related to exploration and development.

## 4. Capital Assets

| | Cost $ | Accumulated Depreciation $ | 1996 Net Book Value $ | 1995 Net Book Value $ |
|---|---|---|---|---|
| Office equipment | 61,017 | 28,612 | 32,405 | 26,877 |

Depreciation expense for the year amounted to $6,650 (1995 - $5,346).

## 5. Capital Lease Obligation

The future minimum lease payments required to meet obligations for lease of a compressor station are as follows:

| | **1996** | 1995 |
|---|---|---|
| | **$** | $ |
| 1996 | - | 20,614 |
| 1997 | **13,743** | 13,743 |
| | **13,743** | 34,357 |
| Less imputed interest | **2,338** | 4,586 |
| | **11,405** | 29,771 |
| Current portion of capital lease obligation | **11,405** | 18,366 |
| | - | 11,405 |

Interest expense includes $3,298 of capital lease interest (1995 - $4,030)

## 6. Share Capital

Authorized

An unlimited number of common shares without nominal or par value

| | **1996** | | **1995** | |
|---|---|---|---|---|
| | # of Shares | Consideration $ | # of Shares | Consideration $ |
| Balance, beginning of year | 4,208,642 | 4,308,605 | 4,249,242 | 4,350,169 |
| Repurchase of shares | (57,950) | (59,326) | (40,600) | (41,564) |
| Exercise of options | 2,500 | - | - | - |
| Balance, end of year | 4,153,192 | 4,249,279 | 4,208,642 | 4,308,605 |

## 6. Share Capital (Continued)

### a) Stock option

The Company has granted options to officers, directors and employees to purchase common shares as follows:

| | Number of Shares | Exercise Price | Expiry Date |
|---|---|---|---|
| | 150,000 | $1.70 | June 16, 1998 |
| | 243,000 | $0.75 | Feb. 8 to Oct. 17, 2000 |
| | 12,000 | $0.70 | Sept. 28, 2000 |
| | 405,000 | | |

During the year ended June 30, 1996 options for 130,500 common shares expired, options for 2,500 common shares were exercised and options for 175,000 common shares were granted.

### b) Normal course issuer bid

Effective April 24, 1995, the Company commenced a normal course issuer bid under which it may purchase up to 210,682 of its outstanding common shares until April 23, 1996 at the market price of the shares at the time of acquisition. The bid was renewed on May 10, 1996 for a further year with a ceiling of 208,410 common shares. During the year, under the former bid, 42,950 (1995 - 35,600) common shares were purchased at a per share price ranging from $0.70 to $0.85 and under the latter bid, 15,000 (1995 - 5,000) common shares were purchased at a per share price ranging from $0.80 to $0.83 per share, for a total consideration of $44,940 (1995 - $31,650). The stated capital of the shares repurchased amounted to $59,326 resulting in an addition to contributed surplus of $14,386 (1995 - $9,914).

## 7. Income Taxes

The Company's tax provision is comprised of the following:

| | 1996<br>$ | 1995<br>$ |
|---|---|---|
| Provision based on combined basic Canadian federal and provincial income tax rate of 44.6% | **(25,153)** | (79,482) |
| Add (deduct) tax impact of the following items | | |
| Non-deductible crown charges | **(55,773)** | (73,252) |
| Resource allowance on production income | **58,552** | 61,255 |
| Non-taxable Alberta Royalty Tax Credit | **36,491** | 51,632 |
| Miscellaneous | **(2,827)** | (4,798) |
| Recovery of (provision for) income taxes | **11,290** | (44,645) |

## 8. Earnings Per Share

The earnings per share figures are calculated using the weighted monthly average number of shares outstanding during the respective fiscal years. The outstanding stock options do not, at this time, have a dilutive effect on earnings per share.

## 9. Commitments

The Company has a lease obligation covering office space, expiring October 31, 1996. Minimum lease payments over the term of the lease, including operating costs and property taxes, are $5,998.

## 10. Subsequent Event

The Company has entered into a Share Exchange Agreement with two other corporations. The Agreement, with an effective date of July 1, 1996, provides that Western Star will acquire the shares of a newly-formed private corporation in exchange for common stock and warrants of Western Star. This transaction is conditional upon respective Board of Directors' approvals, consent of a majority of Western Star shareholders and normal due diligence to be completed on or before October 10, 1996. Closing is expected in late October, 1996.

# Corporate Information

## HEAD OFFICE

Suite 402,
1000 - 8th Avenue S.W.,
Calgary, Alberta T2P 3M7
Telephone: (403) 237-5060
Fax: (403) 237-6887

## BOARD OF DIRECTORS

**Cliff W. Demetrick** (2)
Calgary, Alberta

**Lyle P. Edwards** (1,2)
Calgary,Alberta

**Daryl S. Fridhandler** (1,2)
Calgary, Alberta

**Kevin J. Gibson** (1)
Okotoks, Alberta

**Norman Raschkowan**
Montreal, Quebec

(1) Audit Committee
(2) Compensation Committee

## OFFICERS

**President**
Kevin J. Gibson, B.Sc., P.Geol.

**Vice-President**
Michel H. Grillot, M.Sc.

**Vice-President, Finance**
Curtis B. Walsh, B.B.A.

**Corporate Secretary**
Judy B. Leverington

## AUDITORS

Deloitte & Touche

## LEGAL COUNSEL

Burnet, Duckworth & Palmer

## EVALUATION ENGINEER

NRG Engineering Ltd.

## BANKER

Canadian Imperial Bank of Commerce

## REGISTRAR AND TRANSFER AGENT

Montreal Trust

## STOCK EXCHANGE

The Alberta Stock Exchange

**Trading Symbol: WSX**

**WesternStar Exploration Ltd.**

This new corporate logo illustrates the evolution of Western Star into a stronger company, determined to affirm its presence in the industry and to accelerate its growth.

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